MESA

Annual Report for 1969

MESA PETROLEUM CO.

file

MESA
PETROLEUM CO.

ANNUAL REPORT

APRIL 30, 1969

directors

LESTER A. ANDERSON

JOHN D. KIRKLAND*

WALES H. MADDEN, JR.*

MICHAEL A. NICOLAIS

T. B. PICKENS, JR.*

RICHARD S. SMITH

ROBERT L. STILLWELL

officers

T. B. PICKENS, JR., *President and Chairman of the Board of Directors*

JACK K. LARSEN, *Vice President*

JOHN E. STOBART, *Vice President*

JOHN F. BOROS, *Secretary and Treasurer*

**Member of Executive Committee*

OFFICES

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1212 MAIN STREET
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DENVER, COLORADO 80203

CANADA – BRADIE BUILDING, 630 6TH AVENUE S.W.
CALGARY, ALBERTA, CANADA

MESA PETROLEUM CO.

interim report

FOR THE SIX MONTHS ENDED

JUNE 30, 1969

To Our Shareholders:

As stated in our annual report for the year ended April 30, 1969, Mesa is changing to a calendar year basis of reporting beginning with the calendar year 1969. This is our first interim report on the new basis and covers operations for the six months ended June 30, 1969.

Gross revenues during the six months period totaled $7,828,404 versus $8,407,449 during 1968. Net income totaled $3,307,558, equivalent to $.88 per share (including $.01 extraordinary) on 3,746,458 average shares outstanding, compared with $2,942,793, or $.74 per share on 3,992,313 average shares outstanding in 1968. Per share calculations are based on the average number of common shares outstanding during each period and assuming conversion of all Preferred stock which is considered to be common stock equivalent in both periods.

Mesa's oil and gas exploration continues on schedule. A 117 well development drilling program, at an estimated cost of $5 million, was commenced in June, 1969 in the Panoma Council Grove Field located in Grant and Stevens Counties, Kansas. To date 21 wells have been completed and plans are to complete all of the wells by January 1, 1970. We are currently participating in the drilling of the fourth development well in the East Oak Grove area of Louisiana. Mesa's interest varies from 10 percent to 25 percent in approximately 17,500 acres in this area. Based on current geological data, several additional locations will be drilled in this field. In the Senex Creek area of northern Alberta, we have participated in the drilling of six productive wells to date. Mesa's interest varies from ten to one hundred percent in about 100,000 acres in this area. Additional exploratory drilling continues in the Midcontinent, Rocky Mountain and Gulf Coast areas.

On May 14, 1969 Mesa announced its initial step in the field of agribusiness. The acquisition of Swisher County Cattle Company, Harman-Toles Elevator Company and Harman & Toles Grain Company was consummated on June 18, 1969 for a total consideration of 84,144 shares of common stock. On August 1, 1969, Mesa acquired Randall County Feed Yard, Inc., and Central Leasing Company for 75,000 shares of common stock, $1 million in cash and assumption of indebtedness of approximately $1 million. Under the terms of the agreement, Mesa will pay up to an additional 75,000 shares of common stock contingent upon Randall's earnings over the next three years. These acquisitions were made by Mesa Agro Inc., a wholly-owned subsidiary of Mesa. With the current capacity and present expansion program, we should have a custom feeding capacity of 100,000 cattle by October 1st and 200,000 cattle within two years. All of the acquired companies are well established and profitable businesses which are a logical supplement to a natural resource company such as Mesa.

Our outlook going into the second half of calendar year 1969 is favorable, and we anticipate record volume and profits for the year.

Sincerely,

T. B. Pickens, Jr.

T. B. PICKENS, JR.
President

August 1, 1969

consolidated statement of income

(Subject to Year-End Audit)

	Six Months Ended June 30 1969	1968
REVENUES:		
Natural gas and oil sales	$5,000,143	$5,343,214
Products extracted from natural gas	578,236	879,475
Proceeds from drilling arrangements and sales of oil and gas leases held for resale	1,393,232	1,813,906
Feed and grain sales	540,689	—
Other income	316,104	370,854
	$7,828,404	$8,407,449
EXPENSES:		
Operating expenses and royalties	$1,349,671	$1,392,265
Cost of drilling arrangements and sales of oil and gas leases held for resale	631,329	1,027,094
Cost of feed and grain sales	455,924	—
General and administrative	670,425	494,494
Interest	599,159	102,872
Depreciation, depletion and amortization	556,727	558,931
Provision for Federal and state income taxes	315,000	1,889,000
	$4,578,235	$5,464,656
INCOME BEFORE EXTRAORDINARY GAIN	$3,250,169	$2,942,793
GAIN ON SALE OF MARKETABLE SECURITIES net of taxes	57,389	—
NET INCOME	$3,307,558	$2,942,793
EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE (based on average shares of common stock outstanding and assuming conversion of all Preferred stock which is considered to be common stock equivalent):		
Income before extraordinary gain	$.87	$.74
Gain on sale of marketable securities	.01	—
Net income	$.88	$.74

Financial Review *For The Years Ended April 30*

MESA PETROLEUM CO.

	1969	1968
Gross revenues	$16,404,000	$16,214,000
Cash flow	$ 7,252,000	$ 6,875,000
Per share*	$ 1.87	$ 1.74
Net income	$ 6,220,000	$ 5,841,000
Per share*	$ 1.61	$ 1.48
Stockholders' equity	$15,540,000	$21,462,000
Per share*	$ 4.01	$ 5.42
Average number of shares outstanding during each period*	3,873,440	3,956,137
Oil and gas liquid sales — net bbls.	1,039,000	965,000
Gas sales — net MMCF	44,483	46,577

* Based on the average number of common shares and assuming conversion of all preferred stock which is considered to be common stock equivalent.

To Our Shareholders:

On April 29, 1969, the stockholders of Mesa and Hugoton Production Company approved the merger of Hugoton into Mesa; such merger became effective on April 30, 1969. The terms of the merger are outlined in detail in the notes to financial statements beginning on page 8.

For the fiscal year ended April 30, 1969, which includes the results of Hugoton on a pooling-of-interest basis, gross revenues rose to a record $16,404,476, compared with $16,214,086 one year ago. Net income increased to a record $6,219,988 (including $186,266 extraordinary gain) from $5,840,635 (including $319,879 extraordinary gain) in the prior year. Earnings per share were $1.61 (including $.05 extraordinary) on 3,873,440 common shares outstanding, compared to $1.48 (including $.08 extrordinary) on 3,956,137 common shares for the same period last year. Per share results are based on the average number of common shares outstanding during each period and assuming conversion of all preferred stock which is considered to be common stock equivalent in both years.

Prior to the merger with Hugoton, Mesa has reported to its shareholders on an April 30th fiscal year basis. Hugoton previously reported on the basis of a calendar year. The Board of Directors on July 31, 1969 amended Mesa's by-laws and adopted calendar year reporting beginning with the calendar year 1969. Since the Company held a special meeting of its shareholders on April 29, 1969, and at that meeting elected new directors, no annual meeting will be held in 1969. An annual report for the calendar year 1969 will be issued, and the next annual stockholders' meeting will be held on the last Wednesday in April, 1970. In line with Mesa's change to a calendar year, a semi-annual report for the six months ended June 30, 1969 is enclosed with this report.

The Company's oil and gas exploration program continues at a rapid pace. Capital expenditures net to Mesa's interest totaled approximately $3,500,000 during the year ended April 30, 1969. Significant discoveries were encountered in the East Oak Grove area of Louisiana and the Senex Creek area of Alberta, Canada. Development drilling is progressing satisfactorily in both areas. During the calendar year 1969, capital expenditures net to Mesa's interest are budgeted at approximately $9,000,000.

Principal areas of concentration in the current year will continue to be the Gulf Coast, the Mid-continent, the Rocky Mountains and Canada. With increased financial and mineral resources, we believe that Mesa is at the threshold of its greatest period of sustained growth and expansion. We will keep you informed of our progress.

Sincerely,

T. B. Pickens, Jr.
President

August 1, 1969

Consolidated Statements of Income

For Twelve-Month Periods Ended April 30, 1969 and 1968

MESA
PETROLEUM CO.
AND SUBSIDIARIES

	1969	1968*
REVENUES:		
Oil and gas sales	$ 9,968,496	$ 9,618,539
Products extracted from natural gas	1,419,255	1,446,815
Proceeds from drilling arrangements and sales of oil and gas leases held for resale	4,176,367	4,494,652
Gilsonite sales, dividends, interest, and other income	840,358	654,080
	$16,404,476	$16,214,086
EXPENSES:		
Operating expenses and royalties	$ 2,716,608	$ 2,581,080
Cost of drilling arrangements and sales of oil and gas leases held for resale	2,384,724	2,859,585
General and administrative	1,307,614	1,055,234
Interest	591,234	135,159
Depreciation, depletion, and amortization (Note 2)	1,032,074	1,034,272
Provision for Federal and state income taxes (Note 3)	2,338,500	3,028,000
	$10,370,754	$10,693,330
INCOME BEFORE EXTRAORDINARY GAIN	$ 6,033,722	$ 5,520,756
GAIN ON SALE OF MARKETABLE SECURITIES, net of taxes	186,266	319,879
NET INCOME (Note 3)	$ 6,219,988	$ 5,840,635
EARNINGS PER COMMON SHARE AND COMMON EQUIVALENT SHARE (based on average shares of common stock outstanding and assuming conversion of the $2.20 cumulative convertible senior preferred stock and the $2.20 cumulative convertible preferred stock which are considered to be common stock equivalents in both periods):		
Income before extraordinary gain	$1.56	$1.40
Gain on sale of marketable securities	.05	.08
Net income	$1.61	$1.48

* The 1968 statements, which are not covered by the auditors' report, combine Hugoton for the year ended December 31, 1967, with Mesa for the fiscal year ended April 30, 1968.

(See accompanying notes to financial statements.)

MESA PETROLEUM CO.
AND SUBSIDIARIES

Consolidated Balance

Assets

	1969	1968*
Current Assets:		
Cash (including $1,500,000 certificates of deposit in 1969)	$ 2,276,592	$ 2,040,173
Marketable securities, at cost (market value of approximately $5,800,000 in 1969 and $3,600,000 in 1968)	5,250,771	3,324,867
Accounts receivable	2,850,177	3,256,212
Inventories, at cost —		
Oil and gas leases held for resale within one year	1,245,830	1,234,924
Other	125,218	141,496
Prepaid expenses	54,405	40,225
Total current assets	$11,802,993	$10,037,897
Investments, at cost	$ 142,133	$ 120,235
Property, Plant and Equipment, at cost (Note 2):		
Plant, producing and nonproducing oil and gas leases, wells and equipment	$27,643,950	$24,165,738
Gilsonite mining properties, plant, and equipment	1,251,925	1,155,870
Automotive, office, and other properties	182,098	357,936
	$29,077,973	$25,679,544
Less — Accumulated depreciation, depletion, and amortization	7,313,206	6,311,953
	$21,764,767	$19,367,591
Deferred Charges and Other Assets:		
Debt discount expense	$ 289,409	$ —
Cash surrender value of life insurance	170,092	105,483
Deposits and deferred charges	62,088	69,982
	$ 521,589	$ 175,465
	$34,231,482	$29,701,188

* The 1968 statements, which are not covered by the auditors' report, combine Hugoton for the year ended December 31, 1967, with Mesa for the fiscal year ended April 30, 1968.

(See accompanying notes to financial statements.)

Sheets APRIL 30, 1969 AND 1968

MESA PETROLEUM CO. AND SUBSIDIARIES

Liabilities

	1969	1968*
CURRENT LIABILITIES:		
Current maturities on long-term debt	$ 257,000	$ 11,500
Short-term notes payable	855,341	—
Accounts payable and accrued liabilities	1,938,825	1,255,396
Reserve for possible refund (Note 4)	430,000	430,000
Accrued Federal income taxes	266,795	2,621,748
Dividends declared	279,450	—
Current liabilities, excluding short-term notes payable to be refinanced	$ 4,027,411	$ 4,318,644
Short-term notes payable to a bank due August 28, 1969, to be refinanced	8,309,568	—
Total current liabilities	$12,336,979	$ 4,318,644
LONG-TERM DEBT (Note 5):		
5½% convertible debentures due 1983	$ 6,500,000	$ —
6¾% note payable to a bank	—	3,860,000
Other unsecured long-term obligations	24,651	31,965
	$ 6,524,651	$ 3,891,965
Less — Current maturities	257,000	11,500
	$ 6,267,651	$ 3,880,465
DEFERRED CREDITS	$ 86,559	$ 40,105
STOCKHOLDERS' INVESTMENT (Notes 1, 6, and 7):		
Preferred stock, $1 par value, issuable in series, 5,000,000 shares authorized —		
$2.20 cumulative convertible senior preferred stock, issued 1,117,801 in 1969 and 1,252,795 shares in 1968 (liquidating preference of $83,835,075 in 1969)	$ 1,117,801	$ 1,252,795
$2.20 cumulative convertible preferred stock, issued 265,381 in 1969 and 458,965 shares in 1968 (liquidating preference of $19,903,575 in 1969)	265,381	458,965
Common stock, $1 par value; authorized, 5,000,000 shares; issued, 1,147,382 in 1969 and 798,659 shares in 1968	1,147,382	798,659
Capital surplus	4,136,285	8,154,395
Reinvested earnings	8,873,444	10,797,160
	$15,540,293	$21,461,974
	$34,231,482	$29,701,188

* The 1968 statements, which are not covered by the auditors' report, combine Hugoton for the year ended December 31, 1967, with Mesa for the fiscal year ended April 30, 1968.

(See accompanying notes to financial statements.)

Consolidated Statements of Reinvested Earnings and Capital Surplus

MESA PETROLEUM CO. AND SUBSIDIARIES

For the Twelve-Month Periods Ended April 30, 1969 and 1968

	1969	1968*
Reinvested Earnings:		
Balance, beginning of period	$10,797,160	$10,193,929
Net income for the period	6,219,988	5,840,635
Cash dividends —		
Mesa common stock, $.10 and $.09 per share, respectively	(79,866)	(58,574)
Hugoton common stock, $1.75 and $2.00 per share, respectively	(2,309,016)	(3,423,520)
Mesa $2.50 preferred stock, $1.25 per share in 1969	(382,834)	—
Stock dividend	—	(1,755,310)
Adjustment to reflect Hugoton's net income and dividends for the four months ended April 30, 1968	20,416	—
Elimination of Mesa's 8% investment in Hugoton which was acquired for cash (Note 1)	(5,392,404)	—
Balance, end of period	$ 8,873,444	$10,797,160
Capital Surplus:		
Balance, beginning of period	$ 8,154,395	$ 2,852,528
Excess market value over par value of 10% stock dividend	—	1,696,308
Excess of conversion amount over par value of 152,817 shares of common stock issued in connection with the conversion of $3,979,000 of 5¾% convertible subordinated debentures due 1982, less unamortized bond issuance costs of $215,779	—	3,610,404
Stock options exercised (Note 6)	5,975	(4,845)
Conversion of 193,584 shares of $2.50 cumulative convertible preferred stock	(154,960)	—
Expenses incurred in connection with the merger of Mesa and Hugoton	(990,970)	—
Elimination of Mesa's 8% investment in Hugoton which was acquired for cash (Note 1)	(2,878,155)	—
Balance, end of period	$ 4,136,285	$ 8,154,395

(See accompanying notes to financial statements.)

Consolidated Statements of Source and Use of Funds

For the Twelve-Month Periods Ended April 30, 1969 and 1968

	1969	1968*
FUNDS WERE OBTAINED FROM:		
Net income	$ 6,219,988	$ 5,840,635
Depreciation, depletion, and amortization	1,032,074	1,034,272
Net proceeds from sale of convertible debentures	6,210,591	3,763,222
Long-term borrowing	—	3,860,000
Short-term notes payable due August 28, 1969	8,309,568	—
Proceeds from exercise of stock options	6,250	16,057
	$21,778,471	$14,514,186
FUNDS WERE USED FOR:		
Capital expenditures, net of retirements	$ 3,429,250	$ 6,494,745
Payment of cash dividends	2,771,716	3,482,094
Reduction of long-term debt	4,112,814	2,244,075
Acquisition of 8% of Hugoton Production Company common stock for cash prior to merger of Mesa and Hugoton	8,405,553	—
Expenses of the merger of Mesa and Hugoton	990,970	—
Other, net	11,839	148,276
Increase in working capital, excluding short-term notes payable to a bank due August 28, 1969	2,056,329	2,144,996
	$21,778,471	$14,514,186

* The 1968 statements, which are not covered by the auditors' report, combine Hugoton for the year ended December 31, 1967, with Mesa for the fiscal year ended April 30, 1968.

(See accompanying notes to financial statements.)

Notes to Consolidated Financial Statements

April 30, 1969

(1) Principles of Consolidation —

On April 29, 1969, the stockholders of Mesa Petroleum Co. and Hugoton Production Company approved the merger of Hugoton into Mesa; such merger became effective April 30, 1969.

Prior to the merger and pursuant to an exchange offer, Mesa acquired 458,965 shares of Hugoton common stock in exchange for an equal number of shares of Mesa's $2.50 cumulative convertible preferred stock. In addition, Mesa purchased 134,994 shares of Hugoton common stock in the open market for $8,405,553.

Under the terms of the merger each share of Hugoton common stock (other than the shares owned by Mesa) was exchanged for one share of a new series of $2.20 cumulative convertible senior preferred stock of Mesa. The senior preferred stock is entitled to one vote per share and preferential annual cash dividends of $2.20 per share, is convertible into 1.875 shares of common stock of Mesa until March 1, 1974, and 1.6 shares thereafter, is entitled to a preferential payment of $75 per share on liquidation, and is redeemable at $85 per share until March 1, 1974, and $75 per share thereafter.

The outstanding common stock of Mesa is unchanged in the merger. However, the terms of Mesa's outstanding $2.50 preferred stock issued in Mesa's exchange offer to Hugoton stockholders in November, 1968, were amended to provide for a $2.20 annual dividend and for conversion into 1.875 shares of Mesa's common stock until March 1, 1974, and into 1.6 shares thereafter. The basic terms of such outstanding preferred shares and of the senior preferred stock are identical, except that the senior prefered stock has preferential rights as to dividends and distributions in liquidation.

The accompanying consolidated financial statements, which include all subsidiaries of Mesa, reflect the merger of Hugoton into Mesa on a pooling-of-interests basis. In connection with the pooling, the 134,994 shares of Hugoton common stock purchased by Mesa in the open market for $8,405,553 were cancelled by a charge to common stock ($134,994), capital surplus ($2,878,155) and reinvested earnings ($5,392,404).

An analysis of the shares of Mesa's capital stock for the twelve-month period ended April 30, 1969, is set forth below:

		Common	*$2.20 Senior Preferred*	*$2.20 Preferred*
Balance, beginning of period —				
Mesa common shares		798,659		
Hugoton common shares, including shares acquired by Mesa for cash, exchanged upon consummation of the merger			1,252,795	
Hugoton common shares acquired in an exchange offer				458,965
Conversion of $2.50 preferred stock		348,448		(193,584)
Cancellation of Hugoton common shares acquired by Mesa for cash			(134,994)	
Stock options exercised		275		
Balance, end of period		1,147,382	1,117,801	265,381
	Total			
Common and common equivalent shares at April 30, 1969	3,740,847	1,147,382	2,095,876	497,589

(2) Accounting Policy Relating to Oil and Gas Properties and Depreciation —

The company follows the accounting policy of capitalizing, for financial purposes, all direct costs incurred in the acquisition, exploration, and development of gas and oil reserves, including nonproductive costs. Such capitalized costs are being amortized on a company-wide composite unit-of-production method

over the aggregate productive life of all of its producing properties. Under this method of accounting, no gains or losses are recognized upon the sale or disposition of oil and gas properties, except in extraordinary transactions. From inception of Mesa on May 1, 1964, through April 30, 1969, nonproductive costs capitalized, net of gains on sales of producing properties which have been credited to property and amortization, amounted to approximately $3,280,000. The provision for depreciation, depletion, and amortization for the year ended April 30, 1969, was computed by pooling Mesa and Hugoton's oil and gas property costs, recoverable reserves and production.

(3) Federal Income Taxes —

Inasmuch as the merger of Mesa and Hugoton did not become effective until April 30, 1969, the provision for Federal income taxes was computed on a separate company basis. Because of the deductibility for tax purposes of certain amounts capitalized and amortized for financial reporting purposes, no provision for Federal or Canadian income taxes for the year ended April 30, 1969, has been necessary for operations conducted by Mesa. As of April 30, 1969, Mesa has estimated unused operating loss carry-forwards of $2,000,000 which are available to reduce Federal income taxes which may be payable in future periods.

For operations conducted by Hugoton, the provision for Federal and state income taxes was based on actual taxes payable for the eight months ended December 31, 1968, and for the four months ended April 30, 1969, the provision for Federal and state income taxes was based on the calendar year 1969 estimated effective tax rate, which gives effect to $5,000,000 of estimated intangible drilling costs to be incurred during 1969 on the Hugoton properties. These intangible drilling costs which are capitalized for financial reporting purposes and expensed currently for Federal income tax purposes had the effect of decreasing the provision for Federal and state income taxes for the four months ended April 30, 1969, by $905,000.

(4) Federal Power Commission Proceeding —

In a proceeding before the Federal Power Commission, the company is seeking to obtain authorization for the abandonment of a now discontinued sale of natural gas by Hugoton to Panhandle Eastern Pipe Line Company. In April, 1969, the Commission denied the application and ordered Hugoton to make refunds for the years 1961 until the present amounting to approximately $830,000, plus interest thereon. The maximum amount of refund including interest, net of tax effect, is estimated to be $575,000. In May, 1969, the company applied for rehearing of the Commission's opinion.

In prior years, a reserve for possible refunds amounting to $430,000 and the related tax benefit of $180,000 were recorded. In the company's opinion, this reserve is adequate to cover the possible refunds under this proceeding.

(5) Long-Term Debt —

Long-term debt and other obligations at April 30, 1969, and amounts due within one year are as follows:

	Long-term	*Current*	*Total*
5½% convertible subordinated debentures due 1983	$6,250,000	$250,000	$6,500,000
Other	17,651	7,000	24,651
	$6,267,651	$257,000	$6,524,651

The debentures are convertible at the option of the holder into common stock of the company at the rate of $43.31 (as adjusted for anti-dilution provisions) principal amount of debentures per share. The indenture relating to the debentures contains certain provisions among which (a) Mesa may pay dividends

Notes to Consolidated Financial Statements (Cont'd)

on any class of stock only to the extent of Mesa's earnings subsequent to April 30, 1968, plus cash proceeds of sale of capital stock subsequent to such date, and (b) under certain conditions, Mesa is prohibited from incurring any senior funded indebtedness.

(6) STOCK OPTIONS —

Under qualified stock option plans approved by the stockholders in 1965 and 1969, 234,376 shares of authorized and unissued common stock are reserved for options which may be granted to officers and key employees at prices equivalent to market value on the date of grant. The options become exercisable in four annual installments commencing one year after the date granted and if not exercised, expire five years after the date of grant. As of April 30, 1969, options for 34,283 shares were outstanding at prices ranging from \$8.89 to \$46.37 per share or a total value of \$1,147,616. During the year ended April 30, 1969, options for 275 shares have been exercised at a price of \$22.73 for an aggregate option value of \$6,250 (market value of \$11,481). Upon exercising of options the company credits the capital stock account with the par value of the shares purchased and credits the balance of the cash received to capital surplus and no charge is made to income.

(7) EVENTS SUBSEQUENT TO AUDITORS' REPORT —

On June 18, 1969, Mesa acquired The Swisher County Cattle Co., Harman-Toles Elevator Co., and Harman & Toles Grain Co. for 84,144 shares of Mesa common stock.

On June 27, 1969, Mesa entered into an agreement in principle to acquire Randall County Feed Yard, Inc., and Central Leasing Company for \$1,000,000 cash, assumption of \$1,000,000 of Central's debt and 75,000 shares of Mesa common stock. Under the terms of the agreement, Mesa will pay up to an additional 75,000 shares of Mesa common stock contingent upon Randall's earnings over the next three years.

Auditors' Report

To the Stockholders and Board of Directors,

MESA PETROLEUM CO.:

We have examined the consolidated balance sheet of Mesa Petroleum Co. (a Delaware corporation) and subsidiaries as of April 30, 1969, and the related consolidated statements of income, reinvested earnings, capital surplus, and source and use of funds for the twelve-month period then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements set forth above present fairly the financial position of Mesa Petroleum Co. and subsidiaries as of April 30, 1969, and the results of their operations and their source and use of funds for the twelve-month period then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ARTHUR ANDERSEN & CO.

Houston, Texas
June 13, 1969

MESA PETROLEUM CO. AND SUBSIDIARIES

DIRECTORS

LESTER A. ANDERSON
JOHN D. KIRKLAND*
WALES H. MADDEN, JR.*
MICHAEL A. NICOLAIS
T. B. PICKENS, JR.*
RICHARD S. SMITH
ROBERT L. STILLWELL

OFFICERS

T. B. PICKENS, JR., *President and Chairman of the Board of Directors*
JACK K. LARSEN, *Vice President*
JOHN E. STOBART, *Vice President*
JOHN F. BOROS, *Secretary and Treasurer*

* Member of Executive Committee

TRANSFER AGENTS:

COMMON STOCK —
THE CHASE MANHATTAN BANK (National Association)
THE FIRST NATIONAL BANK OF AMARILLO

PREFERRED STOCK —
IRVING TRUST COMPANY

REGISTRARS:

COMMON STOCK —
IRVING TRUST COMPANY
FIRST NATIONAL BANK IN DALLAS

PREFERRED STOCK —
THE CHASE MANHATTAN BANK (National Association)

AUDITORS:

ARTHUR ANDERSEN & CO.
Houston, Texas

COUNSEL:

SELECMAN AND MADDEN
Amarillo, Texas

BAKER, BOTTS, SHEPHERD & COATES
Houston, Texas

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MESA
PETROLEUM CO.

MESA PETROLEUM CO.

Annual Report 1969

Contents

COVER STORY

The cover illustrates Mesa's diversified interests on the North American Continent.

Financial Highlights

	1969	1968	1967	1966	1965
Revenues	$26,957,000	$16,404,000	$16,214,000	$14,178,000	$11,645,000
Cash flow, excluding extraordinary gain	$ 9,487,000	$ 7,066,000	$ 6,555,000	$ 5,425,000	$ 4,978,000
Income before extraordinary gain	$ 8,257,000	$ 6,034,000	$ 5,521,000	$ 4,653,000	$ 4,341,000
Earnings per common and common equivalent share before extraordinary gain	$2.14	$1.56	$1.40	$1.21	$1.15
Total assets	$78,236,000	$34,231,000	$29,701,000	$22,978,000	$22,150,000
Stockholders' investment	$27,806,000	$15,540,000	$21,462,000	$15,749,000	$16,091,000

Combines the operations of the Company for the four years ended April 30, 1969, and the year ended December 31, 1969, with that of Hugoton Production Company for the three years ended December 31, 1967, the twelve months ended April 30, 1969, and the year ended December 31, 1969, as if they covered the same fiscal periods.

To Our Shareholders

Dear Shareholder,

The year ended December 31, 1969 was of particular significance in the history of our Company. During the year, we consummated a merger with Hugoton Production Company, entered the cattle feeding and grain storage business in the Texas Panhandle, listed our securities on the New York Stock Exchange, reached an agreement in principle for the sale of substantial quantities of additional natural gas, and continued our record of increasing revenues and earnings.

We also continued our active program of evaluation, exploration and development of gas and oil properties in Western Canada and the United States, placing particular emphasis on developing our natural gas reserves in the Hugoton Field of Kansas.

RESULTS OF OPERATIONS

For the fifth consecutive year, Mesa attained increased earnings and revenues.

Revenues for the twelve months ended December 31, 1969 increased to $26,957,000 from $16,404,000 for the twelve months ended April 30, 1969. Net income rose to $8,257,000 from $6,034,000 last year, and per share earnings also advanced to $2.14 from $1.56, computed on a fully-diluted basis and excluding extraordinary gains. We previously announced the change to a December 31 fiscal year.

EXPLORATION AND DEVELOPMENT

The discovery of significant gas and oil reserves depends on qualified people and sufficient financial resources. Mesa materially strengthened its position in this regard during 1969.

We were fortunate in having Mr. Jack K. Larsen join Mesa as Vice President in charge of exploration. Mr. Larsen, who was formerly Manager of Exploration for Southern Natural Gas Company, brings to this vital position a wealth of experience, judgment and ability. His particular knowledge of the off-shore Louisiana area should be of immeasurable value to us. Mr. John E. Stobart, formerly Exploration Superintendent with Chevron Oil Company, joined Mesa as Vice President in charge of our Canadian Division headquartered in Calgary. Mr. Stobart served in various capacities in North and South America during his sixteen years with Chevron.

The acquisitions made during the year, combined with profits generated internally, substantially increase the cash flow available to us for our exploration and development program. We hold considerable acreage in North America, and Mesa now has greater capability of exploiting the potential of these properties.

LEFT
Jack K. Larsen, Vice President, Exploration, (left) and John E. Stobart, Vice President, Canadian Division

RIGHT
Tom Herrick, President, Mesa Agro

PRODUCTION

Mesa's increased production of natural gas and oil sales came primarily from Louisiana and Canada. We have developed our acreage in the Hugoton gas field and will have capacity for increased deliveries of natural gas during 1970. Our present contract with Kansas Power & Light Company calls for minimum annual sales volumes of 40.5 billion cubic feet of gas. In December 1969, Mesa and KP&L agreed in principle on a new contract for the sale of increased volumes of gas. At year-end, definitive terms of the agreement were being developed.

AGRIBUSINESS

After careful study of the economics and potential of the cattle feeding business in the Texas Panhandle, where we are headquartered, we acquired two custom feedlots with a combined present capacity of approximately 100,000 head. Convinced of the long range profit potential of the agribusiness, we formed a new division, Mesa Agro, to expand our interests in this field. Mr. Tom Herrick, who compiled an enviable record at the Randall County Feed Yard which we acquired, has assumed the presidency of this division. In addition, we acquired in late December a company engaged in cattle backgrounding operations which owned approximately 26,000 head of cattle at year-end.

FINANCIAL POSITION

During the year we strengthened our capital funds with the issuance of $13 million of 8% 15-year notes to three institutional lenders, together with 10-year warrants for the purchase of 91,000 shares of common stock of the Company at $45 per share. Of this amount, $7 million was drawn down in September, 1969, and the remaining $6 million was received in January, 1970.

OTHER ACTIVITIES

In late December, 1969, we announced that Mesa had purchased approximately 12% of the outstanding common stock of Southland Royalty Company of Fort Worth, Texas. These shares were acquired from Gulf Oil Corporation for $1,500,000 cash and an 18-month promissory note in the principal amount of $13,741,230. On December 31, 1969, Mesa filed a Registration Statement with the Securities and Exchange Commission covering 2,506,292 shares of $1.40 Cumulative Convertible Senior Preferred Stock which Mesa intends to offer to the stockholders of Southland in exchange for shares of common stock of Southland.

A special stockholders' meeting will be called to approve such offer as soon as the proxy statement is cleared by the Securities and Exchange Commission. The offer will be made only by means of a prospectus following effectiveness of the Registration Statement. Southland management is actively opposing the exchange offer.

A more detailed description of Mesa's activities has been included for your information in this year's report. These pages, together with the financial statements, are intended to give you a better understanding of the operations of your Company.

Sincerely,

April 2, 1970

T. B. Pickens, Jr.
Chairman and President


U.S.S.R.
GREENLAND
ARCTIC ISLANDS
ALASKA
Cook Inlet
VALDEZ
YUKON
NORTHWEST TERRITORIES
B.C.
ALB.
SASK.
EDMONTON
CALGARY
NEW BRUNSWICK
MONTREAL
SAULT ST. MARIE
DULUTH
TORONTO
PORTLAND
CHICAGO
DENVER
SANTA BARBARA
AMARILLO
HOUSTON
PRODUCING AREA
EXPLORATION AREA
DIVISION OFFICE

Canada

This is Mesa's largest Division, both in size of staff and in geographical area. Holdings controlled by this Division approximate 2 million net acres. Our principal efforts are currently being expended in the foothills of western Alberta and eastern British Columbia. We own acreage in this area and are conducting seismic surveys to earn additional acreage and to prepare for bidding at future land sales. This area is in the vicinity of the prolific Strachan-Ricinus gas-condensate fields and holds great promise of additional gas fields of this magnitude.

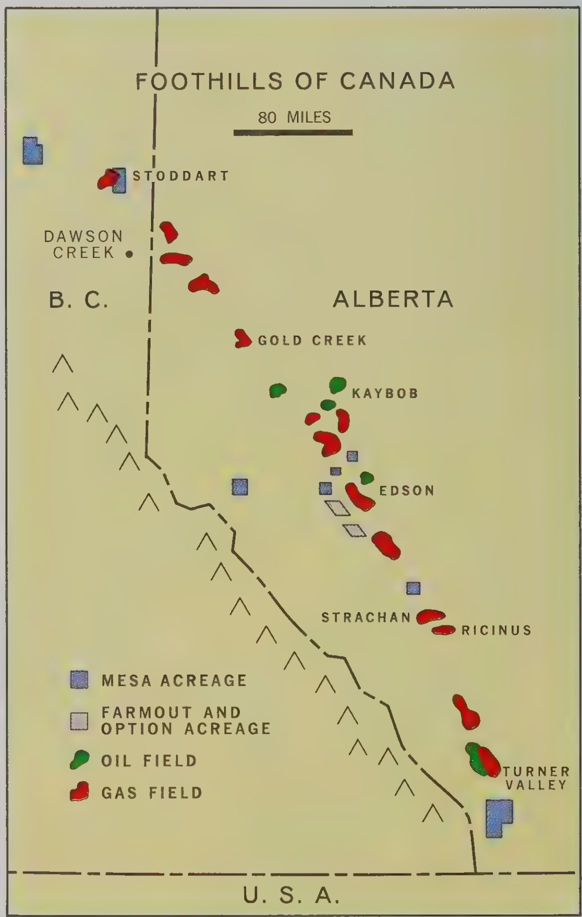
In the plains of eastern Alberta and western Saskatchewan, exploratory work continues on several

EXPLORATION AND DEVELOPMENT

Leaseholds are our inventory and also in a sense our raw material. We lease acreage that has been determined to have gas and oil producing potential. The cost of the leases is a major factor in determining our final cost of finding gas and oil. The other factors included in the determination of finding cost are the expense of carrying the land in inventory, seismic and other geophysical studies, drilling and completion costs.

Mesa continues to be cost-conscious when it comes to acreage, and our land inventory has been judiciously selected to keep our finding costs down. We have in the past sold certain acreage which either failed to meet our expectations or appreciated to a price beyond its worth to Mesa, and we will continue to follow this policy. However, the increase in our drilling budget from internally generated funds now permits us greater flexibility in these activities.

The maps on these pages show the location of our acreage and give indications of our activities on these properties to date. Since our exploration program is continuous, changes will occur throughout the year.



large blocks of acreage which include the oil discovery area of Senex and the gas and oil discovery area at Strome. Further drilling will be necessary in both areas before production can commence. Our holdings in the plains and foothills geologic provinces total almost 400,000 net acres.

Geological and geophysical studies are continuing in the outlying geologic provinces of the Yukon, Northwest Territories and eastern Canada where we own some 1.6 million net acres. The recent discovery of oil in the Mackenzie Delta area of the Northwest Territories has greatly increased the interest of the oil industry in the far north country.

Seismic crew at work in western Canada

The table below shows our acreage position during the last three years:

	Acreage Position*	
	Gross	Net
1969	4,249,000	2,334,000
1968	3,807,000	2,608,000
1967	2,681,000	1,664,000

As indicated, our acreage is widely dispersed to give us diversified exposure. The following table reflects the geographical disposition of our acreage holdings:

Area	Net Acres*
Western Canada and Alaska	2,065,000
Rocky Mountains	239,000
Mid-Continent	23,000
Gulf Coast	7,000
	2,334,000

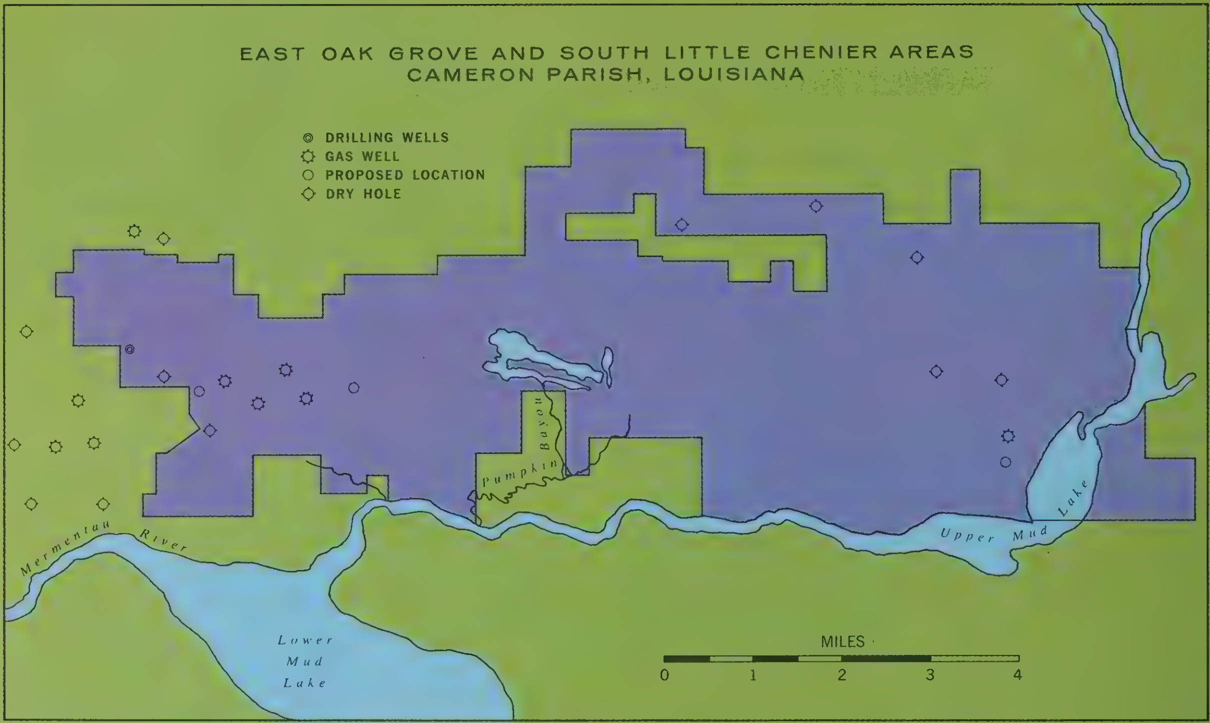
* Includes drilling reservations, petroleum and natural gas reservations, permits and leases.

Mesa's principal effort is directed toward those known gas and oil provinces where large accumulations of hydrocarbons occur and can be developed at economic unit costs; however, a portion of our effort is spent in frontier areas, both domestic and foreign, where large amounts of prospective gas and oil acreage can be controlled at low cost. In order to spread the risk and to participate in the available opportunities, Mesa operates with partners in most of its drilling ventures.

UPPER LEFT
Liquid hydrocarbon extraction plant near Ulysses, Kansas

UPPER RIGHT
Drilling rig offshore Texas

LOWER
Night drilling in Western Canada



Gulf Coast

Mesa began exploring in this area over a year ago and by year-end had established gas-condensate production in three onshore fields, one in Texas and two in Louisiana. Several prospective areas have been scheduled for drilling onshore during 1970, however, a part of our effort will be spent in preparing for bidding at future Federal Offshore lease sales. Intensive seismic and geologic studies, in which we are participating with partners, are in the final stages. This highly prospective area continues to yield large reserves at low unit finding costs. Mesa owns a small interest in a large prospective block in the High Island area offshore Texas, and we expect to conduct further exploratory drilling on this block during the year.

Rocky Mountains

The efforts of this Division are confined largely to exploring for structures in the multiobjective Williston basin of Montana and North Dakota where several attractive Ordovician Red River fields have been discovered in the past two years. Mesa owns some 111,000 net acres in the basin. Elsewhere, we maintain 41,000 net acres in the Powder River basin where the Cretaceous Muddy sandstone play continues to expand. The attractiveness of this stratigraphic play has resulted in little or no acreage being available for leasing; however, we continue to seek suitable opportunities to earn prospective acreage by drilling. We own 38,000 net acres in the Big Horn basin; 35,000 net acres in the Green River basin; and 15,000 acres in other basins, all of which are being actively explored by the industry.

Mid-Continent

This Division's primary function is to explore for new reserves in the Anadarko basin of western Oklahoma and the Texas Panhandle, but it is also responsible for the exploration activities in the Santa Barbara Channel where we own a minor interest in two blocks totaling 11,520 acres. This Division is also responsible for our exploration efforts in Alaska. We expect increased exploratory activity in the Cook Inlet where we own a major interest in over 20,000 acres. In the Gulf of Alaska we are participating in group seismic programs preparatory to bidding at future Federal sales.

Development operations in the Mid-Continent Division include our extensive drilling program to develop the gas reserves in the Council Grove formation of the Hugoton Field in Kansas. Dur-

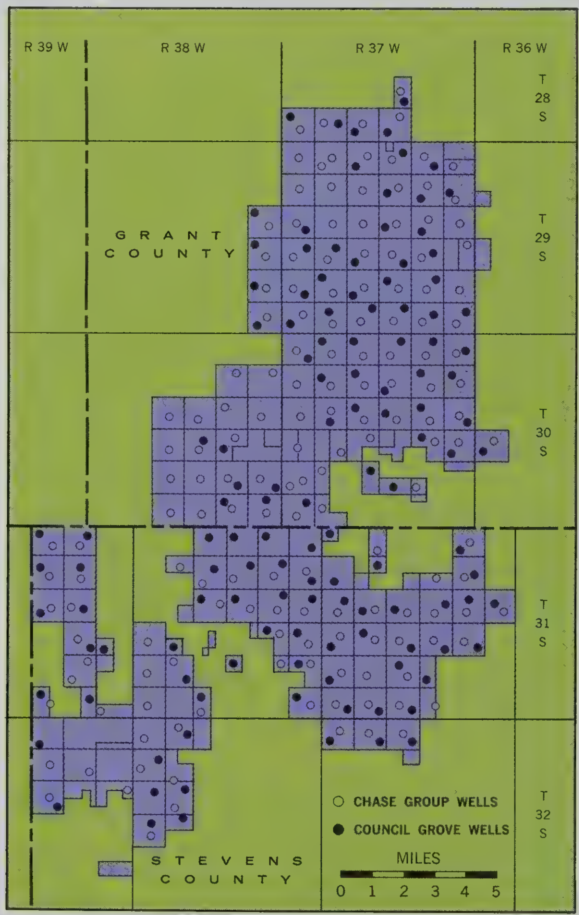
ing the past year, 96 Council Grove wells were drilled, all of which were completed as gas wells. The results of this development program have been very gratifying in that the productivity of the wells has exceeded our expectations. On seven of these Council Grove wells we also tested deeper zones with negative results.

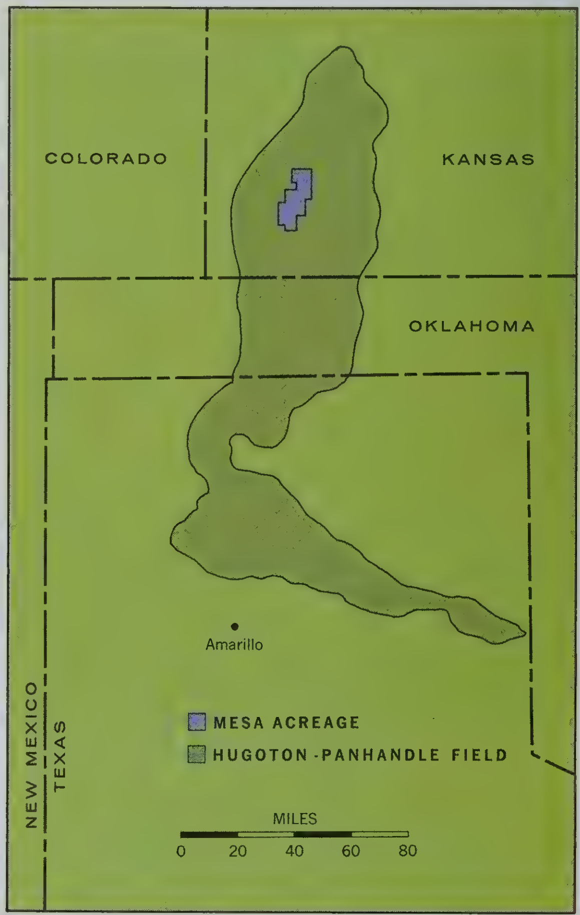
In addition, 71 of the existing 152 Chase Group wells were sand fraced for the first time, greatly improving their deliverability, which will result in increased allowables for these wells. As of December 31, 1969, we had 282 gas wells capable of production in the Hugoton Field, of which 186 were hooked up to transmission lines. Present plans are to have all of these wells on production by mid-1970.

PRODUCTION

The bulk of our production consists of natural gas from the Hugoton Field in Kansas which is sold to Kansas Power & Light Company under long term contracts. Mesa and KP&L have agreed in principle to replace the existing gas sales contracts with a new contract for augmented volumes over a 20-year period. Mesa's net gas reserves in this field, including those presently under contract to KP&L, amount to approximately 1.5 trillion cubic feet. Our development program of the Council Grove reservoir in this field is substantially complete, and it is anticipated that all of the reserves underlying this acreage will be fully developed during the first half of 1970. The maps on this page give a complete picture of the properties in this field and indicate our drilling activities to date.

The gas produced from the Hugoton Field is presently being processed in our liquid hydrocarbon extraction plant located on the properties near Ulysses, Kansas. The plant recovers propane, butane, and natural gasoline from the natural gas stream. In order to realize the full economic advantages from our proposed increased gas sales, it will be necessary to expand the plant capacity. An engineering study of the proposed expansion has been made and it is anticipated that the enlargement will be completed during the last half of 1970. By processing the additional volumes of gas, our recovery of liquid hydrocarbons will be increased.





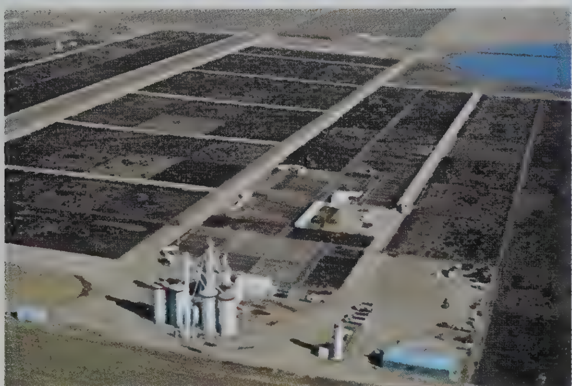
AGRIBUSINESS

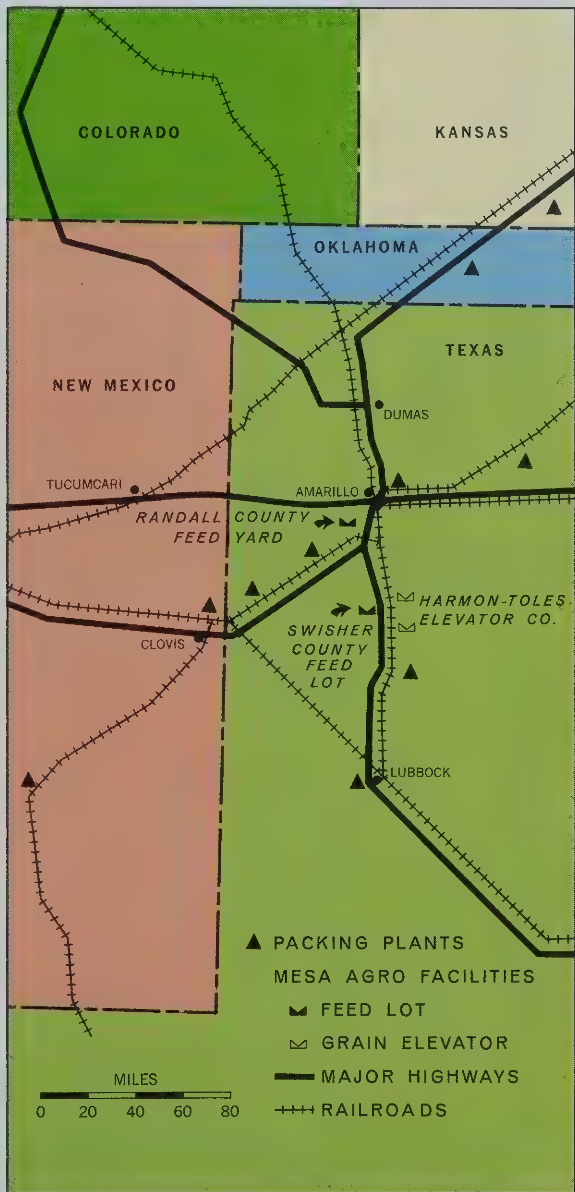
The application of modern methods to livestock feeding can produce highly satisfactory profits, and it was this consideration that prompted us to acquire two well-managed custom feedlots located in our immediate vicinity.

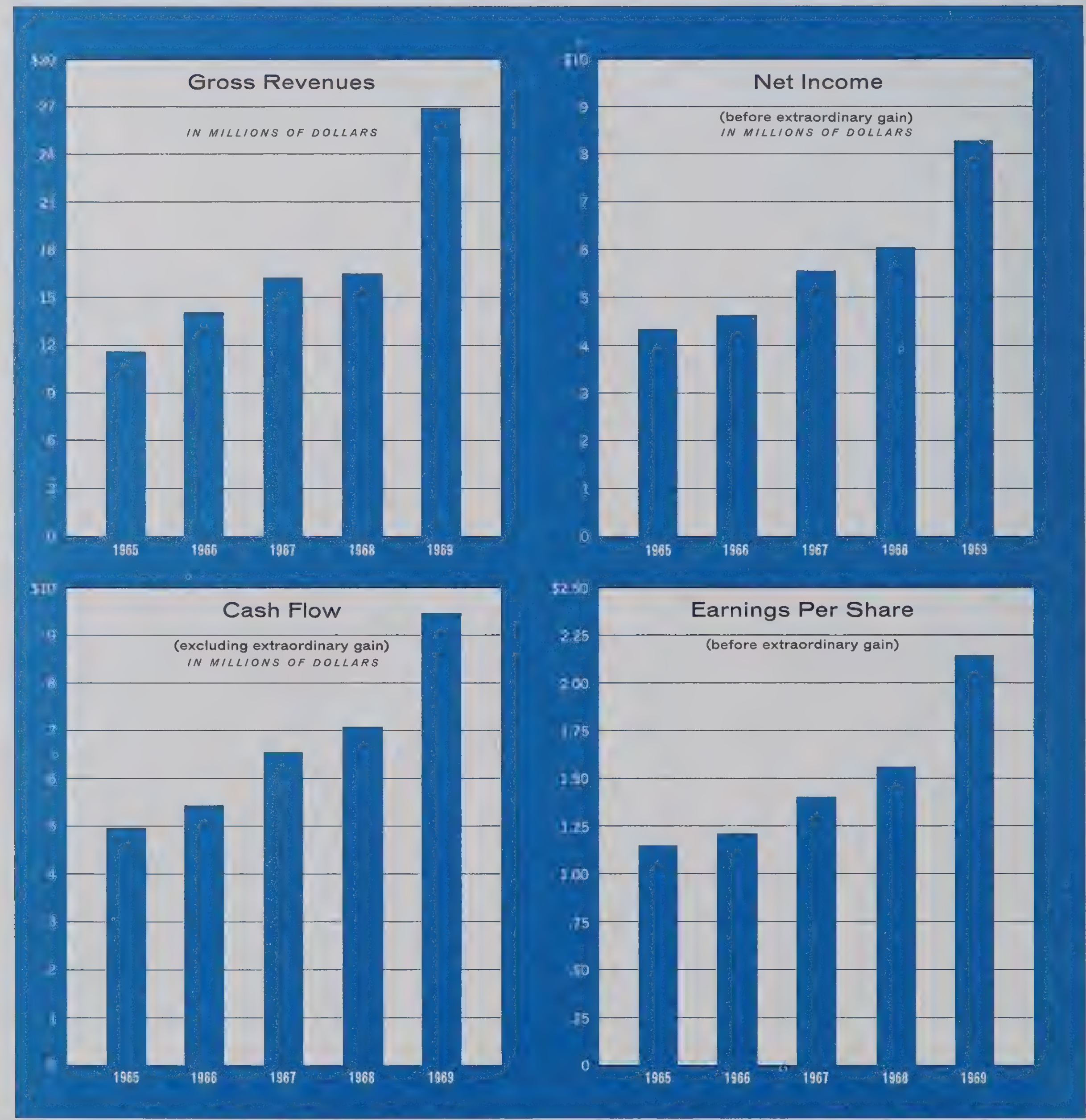
Mesa Agro custom feeds cattle for customers and for its own account prior to the sale to meatpackers. The fee for the custom feeding service is based on the quantity of feed consumed by the animals while they are in the lot. Mechanized feeding methods allow us to perform this function on a more favorable basis than our customers could. In addition, our feedlots deal in large numbers of cattle which permits considerable economies not available to the individual cattle raiser.

Our present capacity of approximately 100,000 head is near some of the largest meatpacking facilities in the world. Cattle and feed grain are locally available and the area is ideally suited to year-round operations.

Mesa Agro is also engaged in the acquisition of beef cattle weighing between 250 and 450 pounds for grazing on wheat or pasture land until the cattle are of the desired weight for placement in the feedlot for fattening. This operation is expected to complement the feedlot business.






Gross Revenues
IN MILLIONS OF DOLLARS
1965
1966
1967
1968
1969
Net Income
(before extraordinary gain)
IN MILLIONS OF DOLLARS
1965
1966
1967
1968
1969
Cash Flow
(excluding extraordinary gain)
IN MILLIONS OF DOLLARS
1965
1966
1967
1968
1969
Earnings Per Share
(before extraordinary gain)
1965
1966
1967
1968
1969

Consolidated Statements of Income

For Twelve-Month Periods Ended December 31, 1969 and April 30, 1969

	December 31, 1969	April 30, 1969
REVENUES:		
Natural gas and oil sales	$10,449,986	$ 9,968,496
Products extracted from natural gas	1,184,216	1,419,255
Proceeds from drilling arrangements and sales of oil and gas leases held for resale	3,231,920	4,176,367
Feed, grain, and cattle operations	11,476,881	—
Gilsonite sales, dividends, interest, and other income	614,169	840,358
	$26,957,172	$16,404,476
EXPENSES:		
Operating expenses and royalties	$ 3,013,120	$ 2,716,608
Cost of drilling arrangements and sales of oil and gas leases held for resale	1,856,752	2,384,724
Cost of feed, grain, and cattle operations	10,030,566	—
General and administrative	1,311,865	1,307,614
Interest	1,258,176	591,234
Depreciation, depletion, and amortization (Note 3)	1,229,318	1,032,074
	$18,699,797	$ 8,032,254
INCOME BEFORE INCOME TAXES AND EXTRAORDINARY GAIN	$ 8,257,375	$ 8,372,222
Provision for federal and state income taxes (Note 4)	—	2,338,500
INCOME BEFORE EXTRAORDINARY GAIN	$ 8,257,375	$ 6,033,722
GAIN ON SALE OF MARKETABLE SECURITIES, net of taxes at April 30	273,908	186,266
NET INCOME (Note 4)	$ 8,531,283	$ 6,219,988
EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE (Note 9):		
Income before extraordinary gain	$2.14	$1.56
Gain on sale of marketable securities	.07	.05
Net income	$2.21	$1.61

(See accompanying notes to financial statements.)

Consolidated Balance Sheets

December 31, 1969 and April 30, 1969

Assets

	December 31, 1969	April 30, 1969
Current Assets:		
Cash (including certificates of deposit of $500,000 at December 31 and $1,500,000 at April 30) (Note 6)	$ 2,512,767	$ 2,276,592
Marketable securities, at cost (market value of approximately $1,423,000 at December 31 and $5,800,000 at April 30)	1,355,765	5,250,771
Accounts receivable	4,807,830	2,850,177
Inventories, at cost which is not in excess of market (Note 6) —		
Oil and gas leases held for resale within one year	1,538,262	1,245,830
Grain, feed, and cattle	7,470,582	—
Other	137,230	125,218
Prepaid expenses	115,619	54,405
Total current assets	$17,938,055	$11,802,993
Investments, at cost:		
Southland Royalty Company, 338,794 shares of common stock representing 12% ownership (Notes 6 and 10)	$15,254,373	$ —
Other	1,494,684	142,133
	$16,749,057	$ 142,133
Property, Plant and Equipment, at cost (Notes 3 and 6):		
Plant, producing and nonproducing oil and gas leases, wells and equipment	$36,412,064	$27,643,950
Grain and cattle feeding facilities	6,401,166	—
Gilsonite mining properties, plant, and equipment	1,299,761	1,251,925
Automotive, office, and other properties	859,985	182,098
	$44,972,976	$29,077,973
Less — Accumulated depreciation, depletion, and amortization	8,588,849	7,313,206
	$36,384,127	$21,764,767
Excess of Cost of Companies Acquired Over Equity in Net Tangible Assets at Date of Acquisition, not being amortized (Note 2)	$ 6,078,065	$ —
Deferred Charges and Other Assets:		
Debt discount expense, net of amortization	$ 747,259	$ 289,409
Cash surrender value of life insurance	155,768	170,092
Deposits and deferred charges	184,016	62,088
	$ 1,087,043	$ 521,589
	$78,236,347	$34,231,482

(See accompanying notes to financial statements.)

Liabilities

	December 31, 1969	April 30, 1969
CURRENT LIABILITIES:		
Current maturities on long-term debt	$ 2,242,227	$ 257,000
Short-term notes payable	—	855,341
Accounts payable and accrued liabilities	7,912,173	1,938,825
Reserve for possible refund (Note 5)	430,000	430,000
Accrued federal income taxes	726,035	266,795
Dividends declared	—	279,450
Current liabilities, excluding short-term notes payable which have been refinanced	$11,310,435	$ 4,027,411
Short-term notes payable which have been refinanced in January, 1970 and September, 1969 (Note 6)	5,538,500	8,309,568
Total current liabilities	$16,848,935	$12,336,979
LONG-TERM DEBT (Note 6)	$35,823,790	$ 6,524,651
Less — Current maturities	2,242,227	257,000
	$33,581,563	$ 6,267,651
DEFERRED CREDITS	$ —	$ 86,559
STOCKHOLDERS' INVESTMENT (Notes 1, 2, 7, 8 and 10):		
Preferred stock, $1 par value, issuable in series, 5,000,000 shares authorized —		
$2.20 cumulative convertible senior preferred stock, issued 851,110 and 1,117,801 shares, respectively (liquidating preference of $63,833,250 at December 31, 1969)	$ 851,110	$ 1,117,801
$2.20 cumulative convertible preferred stock, issued 163,376 and 265,381 shares, respectively (liquidating preference of $12,253,200 at December 31, 1969)	163,376	265,381
Common stock, $1 par value, authorized 5,000,000 shares; issued 2,070,052 and 1,147,382 shares, respectively	2,070,052	1,147,382
Warrants to purchase 49,000 shares of common stock (Note 6)	318,500	—
Capital surplus	11,810,969	4,136,285
Reinvested earnings (Note 6)	12,662,068	8,873,444
Treasury stock, 1,898 shares of common stock, at cost	(70,226)	—
	$27,805,849	$15,540,293
	$78,236,347	$34,231,482

(See accompanying notes to financial statements.)

Consolidated Statements of Reinvested Earnings and Capital Surplus

For the Twelve-Month Periods Ended December 31, 1969 and April 30, 1969

	December 31, 1969	April 30, 1969
REINVESTED EARNINGS:		
Balance, beginning of period	$ 7,123,871	$10,797,160
Net income for the period	8,531,283	6,219,988
Cash dividends —		
Mesa common stock	(162,445)	(79,866)
Hugoton common stock, prior to merger	(916,667)	(2,309,016)
Mesa preferred stocks	(1,913,974)	(382,834)
Adjustment to reflect Hugoton's net income and dividends for the four months ended April 30, 1968	—	20,416
Elimination of Mesa's 8% investment in Hugoton which was acquired for cash (Note 1)	—	(5,392,404)
Balance, end of period (Note 6)	$12,662,068	$ 8,873,444
CAPITAL SURPLUS:		
Balance, beginning of period	$ 4,634,967	$ 8,154,395
Stock options exercised (Note 8)	1,999	5,975
Conversion of cumulative convertible preferred stocks	(354,819)	(154,960)
Expenses incurred in connection with the merger of Mesa and Hugoton	(497,799)	(990,970)
Elimination of Mesa's 8% investment in Hugoton which was acquired for cash (Note 1)	—	(2,878,155)
Excess of market value over par value of common stock issued for companies acquired in 1969 (Note 2)	8,129,184	—
Retirement of $2.20 preferred stock acquired from Harman & Toles Grain Co. (Note 2)	(102,563)	—
Balance, end of period	$11,810,969	$ 4,136,285

(See accompanying notes to financial statements.)

Consolidated Statement of Source and Use of Funds

For the Twelve Months Ended December 31, 1969

	December 31, 1969
Funds Were Obtained From:	
Net income	$ 8,531,283
Depreciation, depletion, and amortization	1,229,318
Fair value of common stock issued for companies acquired in 1969	8,189,039
Long-term borrowings	20,461,978
Short-term notes payable, refinanced in January, 1970	5,538,500
Fair value of warrants to purchase 49,000 shares of common stock issued in connection with Series "A" notes	318,500
Proceeds from exercise of stock options	2,124
	$44,270,742
Funds Were Used For:	
Capital expenditures, net of retirements —	
Oil and gas properties	$10,290,485
Feed, grain and cattle facilities	12,479,231
Other properties	625,873
Investment in Southland Royalty Company	15,254,373
Net additions to other investments and other assets	346,943
Payment of cash dividends	2,993,086
Expenses incurred in connection with the merger of Mesa and Hugoton	497,799
Increase in working capital, excluding short-term notes payable refinanced in January, 1970	1,782,952
	$44,270,742

(See accompanying notes to financial statements.)

Notes to Consolidated Financial Statements

(1) Merger With Hugoton Production Company —

On April 29, 1969, the stockholders of the Company and Hugoton Production Company approved the merger of Hugoton into the Company; such merger became effective April 30, 1969.

Prior to the merger and pursuant to an exchange offer, the Company acquired 458,965 shares of Hugoton common stock in exchange for an equal number of shares of the Company's $2.50 cumulative convertible preferred stock. In addition, the Company purchased 134,994 shares of Hugoton common stock in the open market for $8,405,553.

Under the terms of the merger each share of Hugoton common stock (other than the shares owned by the Company) was exchanged for one share of a new series of $2.20 cumulative convertible senior preferred stock of the Company. The senior preferred stock is entitled to one vote per share and preferential annual cash dividends of $2.20 per share, is convertible into 1.875 shares of common stock of the Company until March 1, 1974, and 1.6 shares thereafter, is entitled to a preferential payment of $75 per share on liquidation, and is redeemable at $85 per share until March 1, 1974, and $75 per share thereafter.

The outstanding common stock of the Company is unchanged in the merger. However, the terms of the Company's outstanding $2.50 preferred stock issued in the Company's exchange offer to Hugoton stockholders in November, 1968, were amended to provide for a $2.20 annual dividend and for conversion into 1.875 shares of the Company's common stock until March 1, 1974, and into 1.6 shares thereafter. The basic terms of such outstanding preferred shares and of the senior preferred stock are identical, except that the senior preferred stock has preferential rights as to dividends and distributions in liquidation.

The accompanying consolidated financial statements, which include all subsidiaries of the Company, reflect the merger of Hugoton into the Company on a 100% pooling of interests basis. In connection with the pooling, the 134,994 shares of Hugoton common stock purchased by the Company in the open market for $8,405,553 were cancelled by a charge to common stock ($134,994), capital surplus ($2,878,155) and reinvested earnings ($5,392,404).

(2) Acquisitions Treated as Purchases —

On June 18, 1969, the Company acquired The Swisher County Cattle Co., Harman-Toles Elevator Co., Harman & Toles Grain Co. and Harman-Toles Seed Company for 84,144 shares of the Company's common stock.

On August 1, 1969, the Company acquired Randall County Feed Yard, Inc., and Central Leasing Company for cash and assumption of debt aggregating approximately $1,950,000 and 75,000 shares of the Company's common stock. An additional 75,000 shares of the Company's common stock were deposited in escrow to be delivered to the former stockholders of Randall or returned to the Company upon the basis of the earnings of Randall for the years 1970, 1971, and 1972. These additional shares have been reflected as issued and outstanding in the accounts of the Company.

On December 24, 1969, the Company acquired all of the capital stock of Central Cattle Company, Inc., for cash and indebtedness aggregating $3,000,000.

The acquisition of each of the above companies has been accounted for as a purchase by the Company, and their operations have been included in the statement of income of the Company from their respective dates of acquisition. The net assets of these companies have been recorded in the accounts of the Company at the value of the total consideration given, including 234,144 shares of common stock of the Company which was valued substantially at quoted market prices on the dates of acquisition. The purchase price of the foregoing acquisitions was assigned first to the net tangible assets acquired based on appraisal values at dates of acquisition and the balance ($6,078,065) is carried as an intangible asset in the accounts of the Company and will not be amortized until such time as a diminution of its value becomes evident.

(3) Accounting Policy Relating to Oil and Gas Properties and Depreciation —

The Company follows the accounting policy of capitalizing, for financial purposes, all direct costs incurred in the acquistion, exploration, and development of gas and oil reserves, including non-productive costs. Such capitalized costs are being amortized on a company-wide composite unit-of-production method over the aggregate productive life of all of its producing properties. Under this method of accounting, no gains or losses are recognized upon the sale or disposition of oil and gas properties, except in extraordinary transactions. From inception of the Company on May 1, 1964, through December 31, 1969, nonproductive costs capitalized, net of gains on sales of producing properties which have been credited to property and amortization, amounted to approximately $4,406,000. Prior to the merger with the Company, Hugoton was not significantly engaged in exploration activities and the amount of exploration costs incurred by Hugoton prior to the merger was insignificant. Effective May 1, 1968, the provision for depreciation, depletion, and amortization was computed by pooling the Company and Hugoton's oil and gas property costs, recoverable reserves and production. For the period prior to May 1, 1968, depreciation and amortization were computed on a separate company basis.

Gilsonite properties, other than mine and mill equipment, are amortized on the unit-of-production method. Depreciation of mine and mill equipment, grain and cattle feeding facilities, and other equipment is provided on the straight-line method of depreciation.

(4) Income Taxes —

Inasmuch as the merger of the Company and Hugoton did not become effective until April 30, 1969, the provision for Federal income taxes was computed on a separate company basis for all taxable periods ending prior to that date. Because of the deductibility for tax purposes of statutory depletion and intangible drilling and exploration costs which are capitalized and amortized for financial reporting purposes, no provision for Federal or Canadian income taxes has been necessary for operations conducted by the Company prior to the merger with Hugoton. Also, because of the deductibility for tax purposes of these items, no provision for Federal, Canadian, or state income taxes was necessary for the year ended December 31, 1969. For operations conducted by Hugoton for the twelve months ended April 30, 1969, the provision for Federal income taxes for financial reporting purposes was based on actual taxes payable for the eight months ended December 31, 1968, and the provision for Federal income taxes for the four months ended April 30, 1969, was based on the estimated effective tax rate for the calendar year 1969 which gave effect to $5,000,000 of estimated intangible drilling costs to be incurred during 1969 on the Hugoton properties. These intangible drilling costs which are capitalized for financial reporting purposes and expensed currently for Federal income tax purposes had the effect of decreasing the provision for Federal income taxes for the four months ended April 30, 1969, by $905,000.

Deferred Federal income taxes applicable to intangible drilling and exploration costs, which are capitalized for financial purposes as discussed in Note (3) and are deducted as incurred for Federal income tax purposes, will be provided for at such time as these reductions reduce the future tax deductions applicable to the Company's present oil and gas properties below the present unamortized book cost of such properties.

As of December 31, 1969, the Company had estimated unused operating loss carry-forwards of approximately $2,000,000 (expiring $780,000 in 1972 and $1,220,000 in 1973) which are available, subject to certain limitations, to reduce Federal income taxes which may be payable in future periods.

The Tax Reform Act of 1969 provides for many changes which may affect the amount of Federal income taxes payable by the Company in future years. The Company estimates that, had this Tax Reform Act been in effect during the entire year of 1969, Federal income taxes payable, before giving any consideration to the utilization of operating loss carry-forwards, would have been increased by approximately $300,000.

(5) Federal Power Commission Proceeding —

In a proceeding before the Federal Power Commission, the Company is seeking to obtain authorization for the abandonment of a now discontinued sale of natural gas by Hugoton to Panhandle Eastern Pipe Line Company. In April, 1969, the Commission denied the application and ordered Hugoton to make refunds for the years 1961 until the present amounting to approximately $830,000, plus interest thereon. The maximum amount of refund including interest through December 31, 1969, net of tax effect, is estimated to be $628,000. In May, 1969, the Company applied for a rehearing of the Commission's opinion, and the application was denied on June 13, 1969. The Company filed a petition to review the Commission's order in the United States Court of Appeals for the Fifth Circuit on July 31, 1969, and the matter is presently pending for briefing and argument in that court.

In prior years, a reserve for possible refunds amounting to $430,000 and the related tax benefit of $180,000 were recorded. In the Company's opinion, this reserve is adequate to cover the possible refunds under this proceeding.

(6) Short-Term Notes Payable and Long-Term Debt —

Short-term notes payable as of December 31, 1969 include $4,808,000 of 8% and 9% notes payable to a bank which were secured by the Company's cattle inventory and a $500,000 certificate of deposit. In January, 1970, these notes, along with other unsecured obligations, were liquidated primarily from the proceeds from the $6,000,000 of 8% notes issued in January, 1970, which are mentioned below.

Long-term debt and other obligations at December 31, 1969, and amounts due within one year are as follows:

	Long-Term	*Current*	*Total*
5½% Convertible Subordinated Debentures due 1983	$ 6,045,245	$ 250,000	$ 6,295,245
Promissory Note due June 26, 1971, bearing interest at 6% per annum until June 1970 and prime rate thereafter	13,741,230	—	13,741,230
8% Secured Notes, Series "A", due 1985	7,000,000	—	7,000,000
8½% unsecured Promissory Notes due in annual installments through January 10, 1973	2,980,000	—	2,980,000
Long-term bank indebtedness maturing from 1970 to 1976, and bearing interest at annual rates from 7½% to 10½%	3,440,053	1,895,358	5,335,411
Other	375,035	96,869	471,904
	$33,581,563	$2,242,227	$35,823,790

The 5½% convertible subordinated debentures due 1983 are convertible at the option of the holder into common stock of the Company at the rate of $43.31 (as adjusted for anti-dilution provisions) principal amount of debentures

per share. The indenture relating to the debentures contains certain provisions among which (a) the Company may pay dividends on any class of stock only to the extent of the Company's earnings subsequent to April 30, 1968, plus cash proceeds of sale of capital stock subsequent to such date, (b) under certain conditions, the Company is prohibited from incurring any senior funded indebtedness, (c) the Company and its subsidiaries must be free of current liabilities for money borrowed for at least 45 days during each period of 12 consecutive calendar months commencing with September 1, 1968 and with the first day of each calendar month thereafter and (d) no subsidiary of the Company may incur funded indebtedness.

The 8% series "A" notes due 1985 were issued to three institutional lenders, along with 10-year warrants for the purchase of 49,000 shares of common stock of the Company at $45 per share. An additional $6,000,000 of such 8% secured notes and warrants for the purchase of 42,000 shares were issued to such lenders in January, 1970. The Company has the option to purchase the warrants at $50 per warrant at any time prior to September 1, 1978. Under the mortgage relating to the Company's 8% secured notes due 1985, the Company has pledged its Hugoton field oil and gas properties and has agreed to pay dividends on any class of stock only to the extent of its unconsolidated earnings subsequent to April 30, 1969. As of December 31, 1969, $3,219,911 was available to the Company free of such restrictions for the payment of dividends. Under the mortgage agreement the Company has agreed to maintain unconsolidated current assets in excess of unconsolidated current liabilities, as defined, and the Company may incur additional indebtedness, not junior to the mortgage notes, only under certain conditions. The mortgage agreement allows the Company, subject to certain conditions and limitations, to secure under the mortgage additional borrowings of $39,000,000. In connection with the acquisition by the Company on December 26, 1969 of 11.9% of the outstanding stock of Southland Royalty Company from Gulf Oil Corporation, the Company (a) issued its eighteen-month promissory note to Gulf in the amount of $13,741,230 and (b) agreed with Gulf that in the event the Company secured additional loans under the mortgage agreement in excess of 50% of the maximum additional amount permitted to be outstanding, such excess over 50% would be applied to repayment of the promissory note held by Gulf.

The notes payable to banks bear interest at annual rates from 7½% to 10½% and mature in varying amounts from 1970 to 1976. Under these bank loans the Company has pledged substantially all of its Canadian and U.S. (other than the Hugoton field) oil and gas properties, has substantially pledged its grain inventories and has partially pledged its feed lot facilities.

(7) Analysis of Common and Preferred Stocks —

An analysis of the Company's common and preferred stocks for the year ended December 31, 1969, is set forth below:

		Common	*$2.20 Senior Preferred*	*$2.20 Preferred*
Balance, December 31, 1968 —				
Company common shares		1,071,751		
Hugoton common shares, including shares acquired by the Company for cash, exchanged upon consummation of the merger			1,252,795	
Hugoton common shares acquired in an exchange offer				307,399
Conversion of $2.50 preferred stock		75,631		(42,018)
Cancellation of Hugoton common shares acquired by the Company for cash			(134,994)	
Conversion of $2.20 senior preferred stock		499,988	(266,691)	
Conversion of $2.20 preferred stock		188,413		(100,505)
Shares issued for companies acquired in 1969		234,144		
Retirement of stock acquired from Harmon & Toles Grain Co.				(1,500)
Stock options exercised		125		
Balance, December 31, 1969		2,070,052	851,110	163,376
	Total			
Common and common equivalent shares at December 31, 1969	3,972,213	2,070,052	1,595,831	306,330

(8) Stock Options —

Under qualified stock option plans approved by the stockholders in 1965 and 1969, 234,114 shares of authorized and unissued common stock are reserved for options which may be granted to officers and key employees at prices equival-

ent to market value on the date of grant. The options become exercisable in four annual installments commencing one year after the date granted and if not exercised, expire five years after the date of grant. As of December 31, 1969, options for 70,646 shares were outstanding at prices ranging from $8.89 to $46.38 per share or a total of $2,669,335. During the year ended December 31, 1969, options for 262 shares have been exercised at prices of $19.09 and $36.63, respectively, for an aggregate option value of $7,194 (market value of $10,462). Upon exercising of options the Company credits the capital stock account with the par value of the shares purchased and credits the balance of the cash received to capital surplus and no charge is made to income.

(9) Earnings Per Share —

Earnings per share have been computed based upon the weighted average of common shares outstanding during each period and assuming conversion of all preferred stocks, and exercise of stock options which have a dilutive effect. The 5½% convertible subordinated debentures and the warrants outstanding have not been considered in computing earnings per share as the effect of the exercise of the warrants and conversion of debentures would not be dilutive.

(10) Proposed Tender Offer to Shareholders of Southland Royalty Company and Litigation —

In late December, 1969, the Company purchased 11.9 percent of the outstanding common stock of Southland Royalty Company. These shares were acquired from Gulf Oil Corporation for $1,500,000 in cash and an 18-month promissory note in the principal amount of $13,741,230. On December 31, 1969, the Company filed a Registration Statement with the Securities and Exchange Commission covering 2,506,292 shares of $1.40 Cumulative Convertible Senior Preferred Stock, which the Company intends to offer to the stockholders of Southland in exchange for each share of common stock of Southland. A special stockholders' meeting will be called to approve such offer as soon as the proxy statement is cleared by the Securities and Exchange Commission. The offer will be made only by means of a prospectus following effectiveness of the Registration Statement. Southland's management is actively opposing the exchange offer. On February 6, 1970 Southland filed a lawsuit against Mesa in the United States District Court for the District of Delaware, alleging certain violations by Mesa of the Securities Act of 1933 and the Securities Exchange Act of 1934 and seeking to enjoin Mesa from making the exchange offer.

Auditors' Report

To the Stockholders and Board of Directors,

Mesa Petroleum Co.:

We have examined the consolidated balance sheet of Mesa Petroleum Co. (a Delaware corporation) and subsidiaries as of December 31, 1969, and the related consolidated statements of income, reinvested earnings, capital surplus, and source and use of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have previously examined and reported on the financial statements as of April 30, 1969.

In our opinion, the financial statements set forth above present fairly the financial position of Mesa Petroleum Co. and subsidiaries as of December 31, 1969, and the results of their operations and their source and use of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Arthur Andersen & Co.

Houston, Texas
March 20, 1970

New York Stock Exchange Executive Vice President John Cunningham (left) welcomes Chairman and President T. B. Pickens, Jr., (center) and Wales H. Madden Jr., Director, to the Trading Floor on the occasion of its stock listing, December 8, 1969.

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Preferred Stock
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REGISTRARS
Common Stock
IRVING TRUST COMPANY
FIRST NATIONAL BANK IN DALLAS

Preferred Stock
THE CHASE MANHATTAN BANK (National Association)

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